House Legislative Analysis Section
House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

ANNUITIES: MINIMUM NONFORFEITURE RATE

House Bill 5999 as introduced
First Analysis (5-23-02)

Sponsor: Rep. Andrew Richner
Committee: Insurance and Financial Services

THE APPARENT PROBLEM:

An annuity is a contract issued by a financial institution, e.g., a life insurance company. Generally, an annuity repays the capital invested by a person over a set period of time plus interest. Individual fixed annuities are often used as an investment strategy for retirement income because an annuity can provide a steady stream of income over the life of the contract.

The minimum nonforfeiture rate, which is the minimum interest rate guarantee that an insurance company can use in an individual fixed annuity contract to determine its cash value, is regulated by the Insurance Code. In 1980, when the minimum nonforfeiture rate was placed in statute, it was based on a rate recommended in 1977 by the National Association of Insurance Commissioners (NAIC). At that time, interest rates were quite high (some in the double digits) and so the minimum rate was set at three percent.

However, the recent economic downtown has sent interest rates plummeting. Many interest bearing investments (for example, certificates of deposit, money market accounts, and savings accounts) offer interest rates of only 2 percent or lower, with many financial institutions offering rates as low as .6 percent. The result is that companies offering annuities are finding it more difficult to offer products that consumers want and to offer those at an attractive interest rate. Reportedly, many companies are no longer offering short-term annuities (one to three years). The concern is that if interest rates continue to be flat for a protracted period of time, that companies who sell annuities could, as a result of paying interest rates in excess of the actual market rates, place their financial stability at risk.

According to industry members and the Office of Financial and Insurance Services (OFIS), the NAIC is studying the issue and working to devise a method by which the minimum nonforfeiture rate could be based on an index. This would allow the minimum rate, or "floor", to move and keep pace with current market conditions. Until such time as this permanent fix is available, industry members have requested that the statute be amended to provide a temporary fix. Therefore, legislation that would lower the minimum nonforfeiture rate for individual fixed annuities from 3 percent to 1.5 percent – for a period of three years – has been proposed.

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to specify a minimum nonforfeiture amount for individual fixed annuity contracts and to define the term "maturity value". The bill would apply to those contracts that provide flexible contracts providing for flexible considerations and would establish a minimum nonforfeiture amount on which to base the minimum values of any paid-up annuity, cash surrender, or death benefits available under the annuity contract. The minimum nonforfeiture amount established in the bill would be applied to those contracts issued between the bill's effective date and January 1, 2005.

The bill would define "maturity value" (beginning on the bill's effective date and continuing until January 1, 2005) as an accumulation up to the maturity date at the rate of interest guaranteed in the contract for accumulating the net considerations to determine the maturity value, but in no event less than 1.5 percent per annum, of the percentages of the net considerations, as defined in the code, paid before that time, decreased by the sum of prior withdrawals from or partial surrenders of the contract accumulated at the rate of interest guaranteed in the contract for accumulating net considerations to determine the maturity value but in no event less than 1.5 percent per annum and the amount of any indebtedness to the company on the contract, including interest due and accrued, and increased by excess interest previously credited by the company to the contract.

MCL 500.4072

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bill has no fiscal impact. (5-22-02)

ARGUMENTS:

For:

When the 3 percent minimum nonforfeiture rate for individual fixed annuities was set in statute over 20 years ago, interest rates were high and it was not envisioned that interest rates could drop below that figure within the foreseeable future. Unfortunately, the national economy has been in a decline for several years, and the events of September 11, 2001 have further stalled recovery. It is impossible to predict how long it will be before the economy begins to grow and the market rates increase again.

One segment of the financial industry particularly impacted is the annuity market. Since annuities can lock in a specified yearly payout for a set investment for a set number of years, they are a popular investment tool, particularly in planning retirement income. According to industry members and the Office of Financial and Insurance Services, many companies have stopped offering short-term annuities (one to three years) because the minimum rate in statute is higher than the current market interest rates. If interest rates continue to be depressed for several more years, the financial stability of some annuity companies could be affected, possibly leading to insolvency.

One way to fix the problem is to rewrite the laws governing the minimum nonforfeiture rates. Industry members have requested the National Association of Insurance Commissioners (NAIC) to help. Reportedly, the NAIC has formed a workgroup and is working to devise a method, along with model legislation, by which the minimum nonforfeiture rate would be tied to current market conditions. That would provide a moveable "floor" and would alleviate the need to amend state statutes whenever the economy made a major shift. However, NAIC estimates that it will take approximately two years, perhaps a little more, to devise an appropriate method. In the meantime, the industry is requesting that the state statute be amended to provide, for new contracts only, that the minimum nonforfeiture rate be lowered to 1.5 percent for a period of under three years. According to testimony offered in committee by the American Council of Life Insurers, six states have already adopted the lower interest rate, six more are considering doing so, and legislation in four states is on their respective governor's desks awaiting signature. If Michigan follows the lead of these other states, consumers will benefit by having more choices in the annuity marketplace.

Dropping the minimum rate would allow companies to reduce guaranteed minimums in their products to reflect the market rates. As the market rebounds, companies are sure to increase their guaranteed rates in order to offer an attractive and competitive product to consumers.

POSITIONS:

The Office of Financial and Insurance Services supports the bill. (5-22-02)

The American Council of Life Insurers (ACLI) supports the bill. (5-22-02)

AIG supports the bill. (5-22-02)

Manulife supports the bill. (5-22-02)

Michigan Farm Bureau supports the bill. (5-22-02)

Jackson National Life supports the bill. (5-22-02)

Prudential Insurance supports the bill. (5-22-02)

Analyst: S. Stutzky

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.